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OF THE CL

No. 92-1517

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

W.M. SCHLOSSER COMPANY, INC.
Petitioner,

v.

SCHOOL BOARD OF FAIRFAX COUNTY, VIRGINIA
Respondent.

ON PETITION FOR CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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April 9, 1993

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QUESTION PRESENTED

Whether the Federal Arbitration Act preempts a principle of Virginia law by which Virginia school boards lack all powers not conferred by the State, including the power to enter into arbitration agreements?

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SCHOOL BOARD OF FAIRFAX COUNTY, VIRGINIA
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RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

The Fairfax County School Board (the "School Board") opposes the Petition for Writ of Certiorari filed by W.M. Schlosser Company, Inc. ("Schlosser"), for the reasons set forth below.

STATEMENT OF THE CASE

(1) Nature of the Case

This is an appeal from the Fourth Circuit Court of Appeals' decision affirming the decision of the District Court declining to compel the School Board to enter into arbitration of a construction delay claim asserted by Schlosser. *W.M. Schlosser Co. v. School Bd. of Fairfax County*, 980 F.2d 253 (4th Cir. 1992). The District Court found that the parties did not intend to arbitrate their disputes, and that the School Board did not have the authority to arbitrate under Virginia law. The Fourth Circuit affirmed. *Id.* at 259. Without reaching the question of whether the parties intended

to arbitrate, the Fourth Circuit agreed with the District Court that school boards in Virginia may exercise only those powers conferred on them by the State, and that, under Virginia's strict construction of this principle, Virginia school boards do not have the authority to arbitrate. *Id.* at 254 n.4, 258. The Court of Appeals rejected Schlosser's contention that the Federal Arbitration Act, 9 U.S.C. §§ 1-16 (1988 & Supp. 1990) ("FAA"), preempted Virginia law on this subject. The Court reasoned that Virginia law prevents local governing bodies from exercising *all* powers not conferred by the State, and that it does not single out arbitration, or discriminate against it. *Id.* at 258-59. Schlosser does not attempt to appeal expressly from the Fourth Circuit's interpretation of Virginia law. Schlosser contends, however, that this interpretation, endorsed by both the District Court and the Court of Appeals, is preempted by the FAA.

(2) Statement of Facts

Schlosser was hired by the School Board in 1988 to perform certain renovation work at Falls Church High School in Fairfax County, Virginia. The Contract provided that Schlosser would substantially complete the renovation project by August 31, 1989, in time for the beginning of the 1989-1990 school year. Schlosser failed to complete the project on time, and was warned in April 1990 that this delay might subject it to liquidated damages under the Contract.

Several months later, Schlosser contended that it was the School Board, not Schlosser, that was responsible for Schlosser's delays, and Schlosser submitted a claim to the School Board for $1,152,941 in damages that it had supposedly suffered as a result. Schlosser's claim was referred to the Architect, who awarded Schlosser a 7-day extension of time for completion of the Contract. The Architect, however, denied Schlosser's claim for money damages.

Schlosser's delay damage claim was barred by the "no-damage-for-delay" provision of the Contract (Petition at 102a, ¶ 7.10.1). Under that provision, any construction delays that were attributable to the School Board or its agents would be credited to Schlosser in the form of an extension of time for performance, and a corresponding reduction in any liquidated damages. Schlosser agreed in the

Contract, however, not to seek any money damages against the School Board resulting from any such delays (*id.*).

The Contract at issue consisted of a number of documents. The primary documents were the American Institute of Architects ("AIA") Standard Form of Agreement and the AIA standard form General Conditions of the Contract for Construction. In addition, the Contract contained a special set of "Modifications to General Provisions," which dealt specifically with the high school renovation project. The AIA standard forms appeared in fine print and occupied 22 single-spaced pages. The Record reflected that no lawyers for either party were involved in drafting the Modifications to the standard forms.

The standard AIA General Conditions contained an article calling for "arbitration" of claims and disputes arising under the Contract (Petition at 74a, Art. 7.10). This article required disputes to be decided by arbitration in accordance with the Construction Industry Arbitration Rules of the American Arbitration Association. The article also set forth the mechanism and procedures for demanding arbitration and provided, among other things, that the contractor would carry on its work during the pendency of any arbitration proceedings, unless the parties agreed otherwise.

This entire arbitration article was specifically and completely deleted by the Modifications, and replaced with the "no-damage-for-delay" clause mentioned above (Petition at 102a). The Record established that it was well known in the construction industry in Virginia that school boards lack any authority to arbitrate. It was also undisputed that the standard arbitration provision was deleted from the Contract in accordance with the school system's long-standing custom and practice of refusing to enter into *ultra vires* arbitration agreements. That practice was based on school officials' understanding that, under Virginia law, school boards do not have the authority to enter into arbitration agreements. 980 F.2d at 254 n.2. There was no evidence in the Record that Schlosser was unaware of this industry custom.

Although the central arbitration provision was deleted in its entirety, the draftsmen failed to delete several other references to arbitration contained in the pre-printed AIA form (Petition at 54a-55a, Arts. 2.2.10, 2.2.11). Schlosser based its demand for arbitration upon these unredacted references. This was the first time that

anyone had ever sought to compel the School Board to arbitrate a construction dispute.

(3) Course of Proceedings

Although the Architect's decision denying Schlosser's claim for delay damages was mailed to Schlosser on February 12, 1991, Schlosser's president, Andrew Schlosser, claimed that he never received it. On March 27, 1991, Schlosser mailed a demand for arbitration to the School Board and promptly filed a Petition to Compel Arbitration the next day in federal court, claiming that the School Board had not yet responded to Schlosser's arbitration demands. This was the first time that Schlosser had ever contended that disputes under the Contract were arbitrable.

The School Board filed an Opposition to Schlosser's Petition and demanded a jury trial of right, pursuant to 9 U.S.C. § 4 (1988), on the question of whether the parties had intended to arbitrate their disputes under the Contract.

The case was first heard by Magistrate Leonie M. Brinkema. The Magistrate found that it was unclear whether the parties had actually intended to arbitrate, given that the main arbitration provision had been deleted from the Contract and that the School Board had intended to eliminate arbitration altogether (Petition at 31a). The Magistrate also agreed that the School Board lacked the authority to arbitrate under Virginia law (*id.* at 32a). Accordingly, the Magistrate denied Schlosser's petition (*id.* at 27a).

Schlosser attempted to appeal the Magistrate's decision directly to the Fourth Circuit, but the Court of Appeals dismissed the appeal for lack of jurisdiction, and remanded the case to the District Court. 980 F.2d at 254 n.3. After another hearing on the merits, the District Court affirmed the Magistrate's findings (Petition at 16a, 26a). The Honorable Claude M. Hilton ruled as follows:

> Well, I find that it was the intent of the parties that the arbitration clause be removed from this contract. It was removed. The primary arbitration clause was taken out of the contract. It went even further when they took it out and said they couldn't even make a claim for these kind of damages.

> It is just clear the intent of the parties was to take out the arbitration provisions in the contract even though it may have been mentioned in passing in another area or two of the contract.
>
> I also find that the School Board doesn't have any authority to arbitrate in Virginia.

(Petition at 26a).

Schlosser appealed both findings to the Court of Appeals for the Fourth Circuit, which affirmed. 980 F.2d at 259. The Court stated that it did not need to reach the question of whether the parties had intended to arbitrate, because it agreed with the Magistrate's and the District Court's conclusion that Virginia school boards lack the authority to arbitrate under State law. 980 F.2d at 254 n.4.

The Court noted that Virginia strictly applies the "Dillon Rule" of statutory construction concerning the powers of local governmental entities:

> According to the Dillon Rule, local governing bodies such as counties, municipal corporations, and school boards "possess and can exercise only those powers expressly granted by the General Assembly, those necessarily or fairly implied therefrom, and those that are essential and indispensable."

980 F.2d at 255 (*quoting City of Richmond v. Confrere Club*, 239 Va. 77, 79, 387 S.E.2d 471, 473 (1990)). The Court pointed out that this rule of statutory interpretation is given particularly strict enforcement by the courts of Virginia, such that " '[i]f there is *any* reasonable doubt whether legislative power exits, that doubt *must* be resolved against the local governing body.' " *Id.* at 255 (*quoting Confrere Club*, 289 Va. at 79-80, 387 S.E.2d at 473) (alteration in original). Indeed, the Court cited one recent case from the Supreme Court of Virginia in which it was held that the power to lease realty could not be implied from a county's express power to sell or

convey realty. *Id.* (*citing County Bd. v. Brown*, 229 Va. 341, 347, 329 S.E.2d 468, 472 (1985)).

The Court of Appeals then canvassed various Virginia authorities, and concluded that Virginia law did not permit the power to arbitrate to be implied from the School Board's power to contract, or from its power to sue and be sued. 980 F.2d at 255-58. The Court undertook an extensive analysis of the Virginia Public Procurement Act, noting that the General Assembly did not provide for arbitration of disputes involving school boards. *Id.* at 256. The Court also observed that the Virginia General Assembly had, in 1987, amended Va. Code Ann. § 15.1-508 (Michie 1989), to provide expressly that county governments (which are separate entities from local school boards in Virginia) could agree to arbitrate, "notwithstanding that county officials had long been authorized to contract by section 15.1-105 of the Virginia Code. . . ." 980 F.2d at 257. The Court noted that no similar amendment had been made to the parallel provisions governing the authority of Virginia school boards, found at Va. Code Ann. § 22.1-71 (Michie 1985). *Id.*

Finally, the Fourth Circuit examined Virginia case law, including decisions of the Supreme Court of Virginia, as well as published and unpublished decisions of the Virginia Circuit Courts. *Id.* at 257-58 & nn. 11-12. The Court observed that its conclusion that Virginia school boards lacked the power to arbitrate was fully consistent with these authorities. *Id.*; *see, e.g., Richard L. Deal & Assocs. v. Commonwealth*, 224 Va. 618, 622, 299 S.E.2d 346, 348 (1983) (holding that agents of the State lacked the authority to enter into arbitration agreements absent an express grant of power from the Virginia General Assembly). Furthermore, the Court noted that any doubt about the existence of such an implied power was required under Virginia law to be resolved against the recognition of that power. 980 F.2d at 258.

Although Schlosser had not argued in the District Court that the Federal Arbitration Act preempted the application of Dillon's Rule in this case, the Court of Appeals rejected that claim as well. *Id.* at 258-59. The Fourth Circuit reasoned that the arbitration provision, even if it had become part of the parties' contract, was *ultra vires* and void under the "savings provision" of § 2 of the FAA, which provides that:

> [a] written provision in . . . a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, . . . shall be valid, irrevocable, and enforceable, *save upon such grounds as exist at law or in equity for the revocation of any contract.*

Id. at 258 (*quoting* 9 U.S.C. § 2 (1988)) (alteration in original). Since the School Board lacked the authority to arbitrate, the arbitration provision was void under § 2.

The Fourth Circuit distinguished this case from situations where a State singles out arbitration for discriminatory treatment, as in *Saturn Distrib. Corp. v. Williams*, 905 F.2d 719, 722 (4th Cir.), *cert. denied*, 498 U.S. 983 (1990). The Fourth Circuit noted that, in *Saturn*, it had invalidated a provision of a Virginia motor vehicle licensing statute that specifically prohibited automobile manufacturers and dealers from entering into agreements that included mandatory alternative dispute resolution provisions. 980 F.2d at 259. In this case, by contrast, the Dillon Rule as applied in Virginia did not single out arbitration agreements for discriminatory treatment, but denied *all* powers to school boards that were not conferred by the State. *Id.* at 259. The Court of Appeals pointed out that its decision was fully consistent with this Court's observation in *Perry v. Thomas*, 482 U.S. 483 (1987), that, under the FAA, "*state law*, whether of legislative or judicial origin, is applicable *if* that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally . . . ." *W. M. Schlosser Co.*, 980 F.2d at 259 (*citing Perry v. Thomas*, 482 U.S. at 492 n.9) (first emphasis added).

Accordingly, the Court of Appeals affirmed the District Court's decision denying Schlosser's Petition to Compel Arbitration. 980 F.2d at 259. Schlosser's petition for a rehearing and suggestion for rehearing in banc was denied (Petition at 14a), and this Petition for Writ of Certiorari followed.

SUMMARY OF ARGUMENT

Applying State law, the Court of Appeals properly ruled that school boards in Virginia do not have the authority to enter into agreements to arbitrate. That conclusion was amply supported by a variety of Virginia legal authorities. Although Schlosser refers to these State law rulings in its Petition as "erroneous," it does not expressly contest these rulings, no doubt because Schlosser is well aware of this Court's "settled practice" of deferring to the Courts of Appeals on matters of State law interpretation. Accordingly, the only issue upon which Schlosser has petitioned for review by this Court is whether the FAA preempts Virginia's application of the Dillon Rule, pursuant to which school boards lack all powers not conferred by the State, including the power to enter into arbitration.

Schlosser cites a number of cases in its Petition in an effort to show that the Fourth Circuit's decision created a split in the Circuits on the preemption issue presented here. Those cases are inapposite, however, because they addressed the question of whether municipal corporations in other States possessed the implied authority to arbitrate under the law of those other States. None of those cases is controlling in Virginia. Moreover, Schlosser has not cited any case that interpreted the preemption issue presented for review here in a manner differently from the Fourth Circuit.

In any event, the Fourth Circuit properly found that Virginia law was not preempted by the FAA. Section 2 of the FAA provides that a written agreement to arbitrate in a contract involving interstate commerce is "valid, irrevocable and enforceable, *save upon such grounds as exist at law or in equity for the revocation of any contract.*" 9 U.S.C. § 2 (emphasis added). This Court observed in footnote 9 of *Perry v. Thomas*, 482 U.S. 483 (1987), that *state law*, whether legislative or judicial, applies to questions concerning contract formation, unless that law singles out or discriminates against arbitration.

Dillon's Rule, as applied in Virginia, denies to municipal corporations and school boards *all* powers not conferred by the laws of Virginia, and this rule is very strictly construed. Arbitration is only one of many powers that school boards are unable to exercise pursuant to this rule. Because Dillon's Rule is, as Schlosser acknowl-

edges, a general rule of contract formation that does not single out arbitration for discriminatory treatment, it is not preempted by the FAA.

Nonetheless, Schlosser urges this Court to adopt a new rule that provides that whenever the *result* of the application of State law is that arbitration cannot go forward, then that State law is preempted by the FAA. This sweeping rule would completely eliminate any need to look to State law because it would create a *per se* rule favoring arbitration. Schlosser does not attempt to anchor this proposed rule in any prior decision of this Court, and the Petition for Certiorari fails even to mention *Perry v. Thomas*.

Moreover, to the extent that Schlosser interprets the FAA as prohibiting States from deciding how their political subdivisions should resolve their legal disputes, Schlosser's unrestrained interpretation would also run afoul of this Court's recent Tenth Amendment jurisprudence. Where an interpretation of a federal statute enacted pursuant to the Commerce Clause would intrude upon areas traditionally occupied by State law, as in this case, preemption will not be presumed. *Gregory v. Ashcroft*, 111 S. Ct. 2395 (1991). Instead, this Court requires that Congress provide a "plain statement" that this is the intended effect of the statute. The legislative history of the FAA, however, conclusively shows that Congress had no intention whatsoever of encroaching upon the rights of the States. Accordingly, the "plain statement" rule of *Gregory* is not satisfied here, and Schlosser's preemption theories must be rejected.

Finally, this case is factually unique. As the District Court determined, the draftsmen of the Contract intended to delete the arbitration provisions in their entirety, but they inadvertently failed to delete several scattered references to arbitration contained in the pre-printed form. Because this case arose solely by virtue of an omission in the drafting process, similar cases are not likely to arise in the future, and the precedential value of this case would be limited.

Accordingly, this Court should deny the Petition for Writ of Certiorari.

ARGUMENT

I. The Court of Appeals Properly Ruled That School Boards Lack the Authority to Arbitrate Under Virginia Law, and This Court Should Not Revisit That State Law Determination.

The principal issue that Schlosser appealed to the Fourth Circuit was whether school boards have the authority to arbitrate *under Virginia law*. Now that the Court of Appeals has ruled squarely against Schlosser on that question, Schlosser couches its Petition to this Court as a request to review whether the Fourth Circuit's interpretation of Virginia law is preempted by the FAA. Although this appeal is ostensibly limited to that issue, however, Schlosser repeatedly asserts in its Petition for Certiorari that the Fourth Circuit's *state law* determinations were erroneous.

Schlosser carefully avoids any discussion of the Fourth Circuit's exhaustive analysis of Virginia law on this subject, *W.M. Schlosser Co.*, 980 F.2d at 255-57, and Schlosser's discussion of the law in other States falls short of the mark. While it is true, as Schlosser contends in part I of its Argument, that local governmental bodies in several other states have been found to have an implied power to arbitrate (Petition at 9-12), these cases are irrelevant to determining whether school boards *in Virginia* have the authority to arbitrate under Virginia law. Schlosser also relies heavily on the 1897 decision of this Court in *District of Columbia v. Bailey*, 171 U.S. 161 (1897), stating that the power to arbitrate may be implied from a municipality's power to contract. Yet *Bailey* applied a general federal common law of municipal corporations that did not survive *Erie R.R. v. Tompkins*.[1] Like the other cases cited by Schlosser, *Bailey* is simply not probative of how Virginia defines the authority of its own political subdivisions.

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[1] 304 U.S. 64, 78 (1938) (abandoning doctrine of *Swift v. Tyson*, 41 U.S. (16 Pet.) 1 (1842), and stating that "[t]here is no federal general common law.").

Schlosser does not challenge the Fourth Circuit's interpretation of Virginia law on this subject, and the reason is obvious. It is this Court's "*settled practice* to defer to the Courts of Appeals on questions of state law." *Daniels v. Williams*, 474 U.S. 327, 341-42 (1986) (emphasis added). This Court has repeatedly declined to revisit the state law determinations made by district courts and courts of appeals, even in cases where "an examination of the state law issue without such guidance might have justified a different conclusion." *Bishop v. Wood*, 426 U.S. 341, 346 (1976); *see also Pembaur v. City of Cincinnati*, 475 U.S. 469, 484 n.13 (1986) ("We generally accord great deference to the interpretation and application of state law by the courts of appeals."); *Butner v. United States*, 440 U.S. 48, 58 (1979) ("The federal judges who deal regularly with questions of state law in their respective districts and circuits are in a better position than we to determine how local courts would dispose of comparable issues."). In *Bishop*, for instance, this Court deferred to the district court's and the divided Fourth Circuit's interpretation of North Carolina law, in the absence of any authoritative interpretation by any North Carolina state court concerning the ordinance at issue. *Id.* at 345-46. Unlike in *Bishop*, however, there was ample Virginia authority on the State law question presented in this case, including at least three directly analogous holdings by the Supreme Court of Virginia. *See W.M. Schlosser Co.*, 980 F.2d at 257-58 & n.11 (collecting cases).

Accordingly, this Court should decline Schlosser's invitation to reexamine the Court of Appeals' interpretation of State law.

II. The Court of Appeals' Decision Creates No Split of Authorities.

Despite several references in the Petition for Certiorari to supposed splits in the Circuits created by the Fourth Circuit's decision, the cases cited by Schlosser simply do not reveal any such division on the question presented here.

In the principal case relied upon by Schlosser, *Johnson Controls, Inc. v. City of Cedar Rapids*, 713 F.2d 370 (8th Cir. 1983), the Court of Appeals found that, *under Iowa law*, the City of Cedar

Rapids had the authority to enter into an arbitration agreement and that, having voluntarily done so, the City could be compelled to arbitrate under the FAA. *Id.* at 373, 379. That holding, of course, is of no moment with respect to whether *Virginia* school boards have the authority to arbitrate under Virginia law. The fact that Virginia law and Iowa law differ on this subject is an unremarkable feature of a multi-State system. It does not amount to a "split" among the United States Courts of Appeals on the federal preemption question presented in this case.

Similarly, Schlosser asserts that *City of Atlanta v. Brinderson Corp.*, 799 F.2d 1541 (11th Cir. 1986), and *County of Middlesex v. Gevyn Constr. Corp.*, 450 F.2d 53 (1st Cir. 1971), *cert. denied*, 405 U.S. 944 (1972), are also at odds with the Fourth Circuit's holding. Like the court in *Johnson*, however, the Eleventh Circuit in *Brinderson* merely held that the City of Atlanta had the power under the law of the State of *Georgia* to enter into an arbitration agreement. 799 F.2d at 1543-44. In *County of Middlesex*, the First Circuit ruled that Massachusetts counties and cities have the authority under *Massachusetts law* to enter into arbitration agreements. 450 F.2d at 55. Neither the Eleventh Circuit nor the First Circuit even addressed the preemption issue.

The state court cases cited by Schlosser likewise fail to show any conflict with the Fourth Circuit's decision concerning federal preemption. In *Lindon City v. Engineers Constr. Co.*, 636 P.2d 1070, 1073-74 (Utah 1981), the Utah Supreme Court held that municipalities had the power to arbitrate under the law of *Utah*. No FAA issue was presented. Similarly, in *Boogher v. Stifel, Nicolaus & Co.*, 825 S.W.2d 27 (Mo. Ct. App. 1992), no question was raised about the authority of a municipality to submit a dispute to arbitration under the law of *Missouri*.

In short, therefore, Schlosser attempts to persuade this Court that there is somehow a split of authorities on the issue of *FAA preemption*, when the only cases Schlosser can point to are those holding that some municipalities in other states have been found to have the authority to arbitrate under *State law*. That Virginia school boards have been held not to have such authority under the law of Virginia does not contradict these cases, and Virginia is not alone

among those jurisdictions applying Dillon's Rule in this fashion.[2] Accordingly, there is no "split of authorities" on the question of whether the FAA preempts a State rule of construction by which municipalities are held to lack all powers not conferred by the State, including the power to arbitrate.

III. The Court of Appeals' Construction of Virginia Law is Not Preempted by the Federal Arbitration Act.

Stripped of its tacit invitation to this Court to review the construction of Virginia law by the courts below, Schlosser's Petition raises only the question of whether the FAA preempts the Fourth Circuit's holding that Virginia school boards lack the authority under State law to enter into agreements to arbitrate. As demonstrated above, Schlosser cites no case that reaches a conclusion on this subject that is contrary to the Fourth Circuit's.

In any event, however, the Fourth Circuit clearly decided this issue correctly under § 2 of the Federal Arbitration Act. That section provides, in pertinent part, as follows:

> A written provision in any . . . contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction . . . shall be valid, irrevocable, and enforceable, *save upon such grounds as exist at law or in equity for the revocation of any contract.*

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[2] *See Local Div. 732, Amalgamated Transit Union v. Metropolitan Atlanta Rapid Transit Auth.*, 253 Ga. 219, 223, 320 S.E.2d 742, 746 (1984), applying the law of Georgia, and deciding the State law and the FAA preemption issues identically to the Fourth Circuit in this case. *Id.* at 223, 320 S.E.2d at 746 ("The arbitration clause here is invalid as an unauthorized arbitration agreement, and in a more general sense it is also invalid as an unlawful delegation of legislative authority. Since any contract unlawfully delegating legislative authority is ultra vires and void, we conclude that this arbitration clause is revocable upon 'grounds as exist at law or in equity for the revocation of any contract.' ").

9 U.S.C. § 2 (1988) (emphasis added). As this Court has recognized, Congress' purpose in 1925 in enacting this "savings clause" in § 2 "was to make arbitration agreements as enforceable as other contracts, *but not more so.*" *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404 n.12 (1967) (emphasis added); *Volt Info. Sciences, Inc. v. Stanford Univ.*, 489 U.S. 468, 478 (1989).

In *Perry v. Thomas*, 482 U.S. 483 (1987), this Court addressed the question of what law must be applied in determining in the first instance whether arbitration has properly become part of the contract between the parties. The Court observed that "*state law*, whether of legislative or judicial origin, is applicable *if* that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally." *Id.* at 493 n.9 (first emphasis added). The Court went on to explain, however, that state law may not single out arbitration for discriminatory treatment as compared to its treatment of other kinds of contracts. *Id.*

A. The Fourth Circuit Correctly Applied Existing Law.

The Fourth Circuit has had three occasions on which to apply these principles, and it has done so correctly each time. First, in *Supak & Sons Mfg. v. Pervel Indus.*, 593 F.2d 135 (4th Cir. 1979), the Fourth Circuit considered a claim that the FAA preempted application of § 2-207 of the Uniform Commercial Code. That case involved the sale of fabric by a New York seller to a North Carolina buyer. Each verbal request by the buyer was memorialized by the seller through a standard confirmation form that contained an arbitration clause. 593 F.2d at 136. After a dispute arose, the seller moved to compel arbitration under this provision. The district court denied the motion, finding that the arbitration provision had not become part of the parties' contract, and the Fourth Circuit affirmed. *Id.* at 137. The Court of Appeals reasoned that, whether construed under the U.C.C. provisions of New York or of North Carolina, an agreement to arbitrate contained in a seller's confirmatory memorandum constituted a "material alteration" to the buyer's offer that did not become part of the parties' contract under U.C.C. § 2-207. *Id.* at 136-37.

The Fourth Circuit specifically rejected the seller's claim that this operation of state law was preempted by § 2 of the FAA. *Id.* at 137. The Court reasoned that § 2-207 expressed a "general rule of contract formation" that did not apply "only to arbitration clauses," but to *any term* in a confirmatory memorandum that constituted a "material alteration." *Id.* Accordingly, § 2-207 was not preempted, even though it prevented arbitration from going forward.[3]

The Fourth Circuit again confronted the preemption issue in *Saturn Distrib. Corp. v. Williams*, 905 F.2d 719, 722 (4th Cir.), *cert. denied*, 498 U.S. 983 (1990). The Court in *Saturn* held that the FAA did preempt a Virginia statute that specifically prohibited automobile manufacturers from entering into agreements that included mandatory dispute resolution provisions. *Id.* at 726. This statute was preempted, the Court reasoned, because it "single[d] out arbitration clauses and unreasonably burdened the ability to form arbitration agreements." *Id.* at 723. The Court distinguished that statute from the "general rule of contract formation" that it had considered in *Supak & Sons*. *Id.* at 726.

Finally, in its holding below in this case, the Fourth Circuit determined that the inability of Virginia school boards to exercise powers not expressly granted to them, including the power to arbitrate, was a general rule of contract formation, and that the case, therefore, was governed by *Supak & Sons*:

> The Dillon Rule . . . does not single out and disproportionately burden arbitration provisions. It is a rule of general applicability that defines and invalidates all *ultra vires* acts of local governing bodies.

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[3] The Fourth Circuit's holding in *Supak & Sons* has been followed by other courts construing the interplay between U.C.C. § 2-207 and § 2 of the FAA. *E.g.*, *Coastal Indus., Inc. v. Automatic Steam Prod. Corp.*, 654 F.2d 375, 379 (5th Cir. Unit B Aug. 28, 1981) ("Whether an arbitration clause is a material alteration is a determination which is made on a state-by-state basis."); *Par-Knit Mills, Inc. v. Stockbridge Fabrics Co.*, 636 F.2d 51, 53 & n.6 (3d Cir. 1980) (holding that a jury trial was required to determine if the parties intended to arbitrate their disputes and, following *Supak & Sons*, assuming that an arbitration provision contained in unilateral confirmation was a material term that did not become part of the parties' contract under U.C.C. § 2-207).

> Unlike the provision drawn into question in *Saturn*, the Rule is not "an idiosyncratic rule specific to arbitration agreements," but is instead "merely an unremarkable part of Virginia's general laws of contract formation." [905 F.2d] at 725. As "a general rule of contract formation," *Supak & Sons Mfg. Co. v. Pervel Indus., Inc.* 598 F.2d 135, 137 (4th Cir. 1979), it constitutes a "ground[] as exist[s] at law or in equity for the revocation of any contract," within the meaning of 9 U.S.C. § 2. As such, it falls within the exception to section 2's general rule of enforceability of arbitration, and therefore is not preempted by the FAA.

980 F.2d at 259. Under Virginia's application of Dillon's Rule, arbitration is treated no better and no worse than any other governmental power that has not been conferred by the legislature. *Cf. County Bd. v. Brown*, 229 Va. 341, 346-47, 329 S.E.2d 468, 471-72 (1985) (holding that the power to lease realty could not be implied from the county's express power to sell or to convey realty).

The FAA does not require that Virginia alter its rules of statutory construction in order to make unauthorized arbitration contracts more enforceable than other kinds of unauthorized contracts. "As the 'savings clause' in § 2 indicates, the purpose of Congress in 1925 was to make arbitration agreements as enforceable as other contracts, *but not more so*." *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404 n.12 (1967) (emphasis added).

The *Supak-Saturn-Schlosser* trilogy of Fourth Circuit cases clearly reflects the correct application of this Court's choice-of-law rules as articulated in footnote 9 of *Perry v. Thomas*, 482 U.S. at 493 n.9 ("[S]tate law, whether of legislative or judicial origin, is applicable *if* that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally."). By contrast, Schlosser advocates a rule that looks only at the *"result"* of the application of State law (Petition at 13) ("While the Dillon Rule, *by itself*, is not subject to preemption, the *result* flowing from the court's misapplication of the Dillon Rule in this case is subject

to preemption.").[4] Schlosser's argument essentially boils down to this: (a) any State law hostile to arbitration is preempted; (b) if applying State law *results* in a denial of arbitration, then that State law must be hostile to arbitration; (c) therefore, all State laws resulting in a denial of arbitration are preempted. This approach, however, would eliminate the need to resort to State law in the first place, since any State law "resulting" in the denial of arbitration would be necessarily overridden. This Court has never promoted such a tortured syllogism, much less the *per se* rule compelling arbitration that Schlosser advocates. Not surprisingly, Schlosser does not attempt to ground such a rule in the decisions of this Court, and the Petition for Certiorari does not even mention this Court's decision in *Perry v. Thomas*.

B. Congress Did Not Intend The FAA to Preempt A State's Right to Determine How Its Local Governing Bodies Resolve Their Legal Disputes.

It is axiomatic that a State's determination of the powers that may be exercised by the various organs of its local government represents a quintessential feature of a State's sovereignty. Indeed, a function of this sort "goes beyond an area traditionally regulated by the States; *it is a decision of the most fundamental sort for a sovereign entity*." *Gregory v. Ashcroft*, 111 S. Ct. 2395, 2400 (1991) (emphasis added). To the extent that Schlosser claims that the preemptive sweep of the FAA is so broad that it forbids States from directing their political subdivisions not to consent to arbitration, whether by affirmatively prohibiting arbitration, or by declining to grant the authority to arbitrate, Schlosser's interpretation would run afoul of this Court's recent Tenth Amendment jurisprudence.[5]

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[4] Thus, Schlosser is forced to concede that Dillon's Rule is a "general rule of contract formation," just like U.C.C. § 2-207 considered in *Supak & Sons*. 593 F.2d at 137.

[5] Judge Niemeyer made precisely this observation at oral argument in the Fourth Circuit, when he stated that if the FAA were interpreted as forbidding States from expressly withholding from municipalities the power to arbitrate, this could

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In *Gregory*, for example, this Court held that the Age Discrimination in Employment Act, 29 U.S.C. §§ 621-634, did not preempt a provision of the Missouri Constitution that imposed a mandatory retirement age on Missouri judges. In so holding, this Court made clear that when Congress enacts a statute pursuant to its powers under the Commerce Clause, the exercise of that power is constrained by the Tenth Amendment, and the Court will not lightly conclude that Congress intended to "upset the usual constitutional balance of federal and state powers." 111 S. Ct. at 2401. The Court applied the following familiar standard:

> "Congress should make its intention 'clear and manifest' if it intends to pre-empt the historic powers of the States. . . . 'In traditionally sensitive areas, such as legislation affecting the federal balance, the requirement of clear statement assures that the legislature has in fact faced, and intended to bring into issue, the critical matters involved in the judicial decision.' "

Id. at 2401 (*quoting Will v. Michigan Dept. of State Police*, 491 U.S. 58, 65 (1989) (citations omitted)). The ADEA failed this "plain statement rule," the Court held, because it was ambiguous with respect to whether Congress intended for appointed state judges to be included within the scope of the ADEA's coverage, even though the Act otherwise extended to the States and their political subdivisions. 111 S. Ct. at 2406.

Applying *Gregory* to the facts of this case requires exactly the same conclusion, particularly since the legislative history of the FAA makes clear that Congress had no intention whatsoever of encroaching upon the States' authority to control how their localities resolve their legal disputes. The legislative history is silent with respect to the FAA's intended effect on contracts to which a State

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unconstitutionally encroach upon the rights of the States to direct the manner in which their local governing bodies resolve their legal disputes. In finding that the FAA did not preempt Virginia's application of Dillon's Rule, however, the Court of Appeals did not have to reach this issue.

or local government was a party. It was clear, however, that the FAA was not viewed as creating a *source* of authority to arbitrate, but only *a mechanism* for the enforcement of arbitration agreements. In fact, Congress did not believe that the FAA even affected substantive rights or that it would encroach upon the rights of the States in any way.

The initial draftsman of the FAA was Julius H. Cohen, a member of the American Bar Association Committee responsible for preparing the FAA, and General Counsel to the New York City Chamber of Commerce.[6] In Joint Hearings before Congress, Mr. Cohen explained that the FAA was needed, not as source of authority to arbitrate as a matter of substantive law, but because the antiquated common law as applied by the federal courts declined to grant specific performance of private arbitration agreements.

> Neither is it true that such a statute, when it declares arbitration agreements to be valid, declares their existence as a matter of substantive law. The courts have always recognized that such agreements have existed but have refused to enforce them. It was often said loosely that arbitration agreements were void, even under the common law rule. This statement was not accurate. While the courts refused to enforce arbitration agreements specifically, they recognized their existence because they gave another remedy. From the earliest times it was held that for a breach of arbitration agreement the aggrieved party was entitled to damages.

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[6] *Arbitration of Interstate Commercial Disputes: Joint Hearings on S. 1005 and H.R. 646 Before the Subcommittees of the Committees on the Judiciary*, 68th Cong., 1st Sess. 13, 15 (1924) [hereinafter *Joint Hearings*]. Following the FAA's enactment, Mr. Cohen also co-authored two of the commentaries illustrative of the contemporary understanding of the scope of the new law. *See* Committee on Commerce, Trade and Commercial Law, *The United States Arbitration Law and Its Application*, 11 A.B.A. J. 153, 156 (1924); Julius H. Cohen & Kenneth Dayton, *The New Federal Arbitration Law*, 12 Va. L. Rev. 265 (1926).

> In no proper sense, therefore, was the arbitration agreement void. It was valid in the same sense that most contracts are valid, i.e., while specific performance would not be given, a remedy for a breach existed in the right to recover damages.

Joint Hearings, *supra* note 6, at 38 (citations omitted).[7] The Senate Report on the Bill echoed this theme,[8] as did the floor debates.[9]

Indeed, the sponsors of the Bill complained that federal courts sitting in states like New York and New Jersey – which had made arbitration agreements enforceable as a matter of State law – were declining to enforce arbitration agreements because they believed

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[7] *See also* Cohen & Dayton, *supra* note 6, at 276-77 (same); Committee on Commerce, Trade and Commercial Law, *supra* note 6, at 155 (same).

[8] The Senate Report stated:

> It is not contended that agreements to arbitrate have no validity whatever. A party may be liable in an action for damages for the breach of an executory agreement to arbitrate; or, if the agreement has been executed according to its terms and an award made, the appropriate action may be brought at law or in equity to enforce the award. Both maritime contracts or transactions and contracts involving interstate commerce are at least valid to this extent.
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> But it is very old law that the performance of a written agreement to arbitrate would not be enforced in equity, and that if an action at law were brought on the contract containing the agreement to arbitrate, such agreement could not be pleaded in bar of the action; nor would such an agreement be ground for a stay of proceedings until arbitration was had. Further, the agreement was subject to revocation by either of the parties at any time before the award. With this as the state of the law, such agreements were in large part ineffectual, and the party aggrieved by the refusal of the other party to carry out the arbitration agreement was without adequate remedy.

S. Rep. No. 536, 68th Cong., 1st Sess. 2 (1924).

[9] 66 Cong. Rec. 984 (1924) (statement of Sen. Walsh) ("In short, the bill provides for the abolition of the rule that agreements for arbitration will not be specifically enforced.").

the issue to be controlled by the law of federal procedure.[10] Although recent decisions by this Court have since grounded the FAA in Congress' powers to regulate interstate commerce,[11] this was not

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[10] *Southland Corp. v. Keating*, 465 U.S. 1, 34 (1984) (O'Connor, J., dissenting) ("[T]he FAA was passed specifically to rectify forum-shopping problems created by this Court's decision in *Swift v. Tyson*, 16 Pet 1, 10 L. Ed. 865 (1842). By 1925 several major commercial States had passed state arbitration laws, but the federal courts refused to enforce those laws in diversity cases."); Joint Hearings, *supra* note 6, at 16 (noting that federal courts sitting in New York and New Jersey would not apply state law favoring arbitration in federal proceedings); *id.* at 39-40 ("the question of the enforcement of [arbitration agreements] relates to the law of remedies and not to substantive law . . . . Every one of the States in the Union might declare such agreement to be valid and enforcable [sic], and still in the Federal courts it would remain void and unenforceable . . . ."); H.R. Rep. No. 96, 68th Cong., 1st Sess. 1 (1924) [hereinafter *House Report*] ("Whether an agreement for arbitration shall be enforced or not is a question of procedure to be determined by the law court in which the proceeding is brought and not one of substantive law to be determined by the law of the forum in which the contract is made. Before such contracts could be enforced in the Federal courts, therefore, this law is essential.").

[11] The genesis of the notion that Congress exercised its powers under the Commerce Clause in enacting the FAA appeared in this Court's decisions for the first time in *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 405 (1967). Subsequently, in *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, this concept matured into the observation in dictum, without citation to the legislative history, that the Act created "a body of *federal substantive law of arbitrability*, applicable to any arbitration agreement within the coverage of the Act." 460 U.S. 1, 24 (1983) (*citing Prima Paint*, 388 U.S. at 395) (emphasis added). This oft-cited quotation from *Moses H. Cone* blossomed into this Court's holding in *Southland Corp. v. Keating*, 465 U.S. 1, 11-12 (1984), where Chief Justice Burger, writing for the Majority, ruled that the FAA created federal substantive law that was enforceable in state courts, but that it did *not* create any independent federal question jurisdiction for federal courts. *Id.* at 15 n.9. *But see id.* at 24-25 (O'Connor, J., dissenting) (stating that the conclusion that the FAA creates "federal substantive rights" "is unquestionably wrong as a matter of statutory construction. . . . One rarely finds a legislative history as unambiguous as the FAA's. That history establishes conclusively that the 1925 Congress viewed the FAA as a procedural statute, applicable only in federal courts, derived, Congress believed, largely from the federal power to control the jurisdiction of federal courts.").

the contemporary understanding at the time of the statute's enactment.[12]

But regardless of whether the FAA was enacted pursuant to Congress' powers under the Commerce Clause, or under its Article III powers to establish and control the federal courts, it is clear that the FAA's drafters were concerned with creating a mechanism for the enforcement of private arbitration agreements,[13] and not with creating a source of authority to agree to arbitrate in the first instance.[14] As a result, the Act was not seen as affecting the authority of the States in any way. Thus, Congress was assured that:

> So far as the present law declares simply the policy of recognizing and enforcing arbitration agreements in the Federal courts *it does not encroach upon the province of the individual States.*
>
> * * *
>
> There is no disposition therefore by means of the Federal bludgeon to force an individual State into an unwilling submission to arbitration enforcement. *The statute cannot have that effect.*

Joint Hearings, *supra* note 6, at 38, 40 (emphasis added); *see also id.* at 37 ("It is no infringement on the right of each State to decide

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[12] Joint Hearings, *supra* note 6, at 37 ("It has been suggested that the proposed law depends for its validity upon the exercise of the interstate-commerce and admiralty powers of Congress. This is not the fact. The statute as drawn establishes a procedure in Federal courts for the enforcement of arbitration agreements. It rests upon the constitutional provision by which Congress is authorized to establish and control inferior Federal courts."); *see also* Cohen & Dayton, *supra* note 6, at 275 (same); Committee on Commerce, Trade and Commercial Law, *supra* note 6, at 155 (same).

[13] House Report, *supra* note 10, at 1.

[14] *See, e.g.*, Cohen & Dayton, *supra* note 6, at 276 ("Neither is it true that such a statute, declaring arbitration agreements to be valid, is the source of their existence as a matter of substantive law.").

for itself what contracts shall or shall not exist under its laws."). Indeed, the Act's sponsor in the House, Representative Graham, stated in the floor debates that the Act "grants *no new rights*, except a remedy to enforce an agreement in commercial contracts and in admiralty contracts." 64 Cong. Rec. 1931 (1924) (emphasis added). Contemporary articles following passage of the Act also observed that it was not intended to encroach in any way upon the authority of the States.[15]

It would be a mockery of these repeated assurances to suggest that Congress somehow intended the FAA to upset the balance between state and federal government by dictating the way in which the States and their political subdivisions must resolve their legal disputes. Such a suggestion would also fly in the face of this Court's recent Tenth Amendment jurisprudence. *E.g., New York v. United States*, 112 S. Ct. 2408, 2420 (1992) ("Congress may not simply 'commandee[r] the legislative processes of the States by directly compelling them to enact and enforce a federal regulatory program.' ") (*quoting Hodel v. Virginia Surface Mining & Reclamation Ass'n*, 452 U.S. 264, 288 (1981)). Indeed, "the Constitution has never been understood to confer upon Congress the ability to require the States to govern according to Congress' instructions." *New York*, 112 S. Ct. at 2421.

No field is more traditionally occupied by State law than the law concerning the scope of authority that may be exercised by a State's political subdivisions. Under Schlosser's view of the FAA, however, States could no longer determine the manner in which their political subdivisions resolve their legal disputes, because States could not withhold the power to arbitrate. Not surprisingly, there is nothing in the text or the legislative history of the FAA to support that result. The "plain statement rule" articulated in *Gregory* is not satisfied here, and Schlosser's expansive construction of the FAA must be rejected. *Accord Volt Info. Sciences, Inc. v. Stanford Univ.*, 489 U.S. 468, 499 (1989) ("The FAA contains no express pre-emptive provision, nor does it reflect a congressional intent to occupy the entire field of arbitration."); *Southland Corp. v. Keating*, 465

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[15] Cohen & Dayton, *supra* note 6, at 276, 277; Committee on Commerce, Trade and Commercial Law, *supra* note 6, at 155.

U.S. 1, 18 (1984) ("The exercise of state authority in a field traditionally occupied by state law will not be deemed preempted by a federal statute unless that was the clear and manifest purpose of Congress.") (Stevens, J., concurring in part, dissenting in part).

IV. The Issue Presented in This Case is Unlikely to Recur.

It is a rare occurrence when municipalities that do not believe themselves to have the power to arbitrate, and that do not intend to enter into arbitration agreements, nonetheless find themselves subjected to motions to compel arbitration. That anomalous situation arose in this case only by virtue of a drafting oversight. While deleting the central arbitration provision and replacing it with a provision that barred the contractor from seeking any damages for construction delays, the drafters of the Contract in this case, unassisted by counsel, inadvertently failed to delete several other references to arbitration contained in the standard, pre-printed AIA form. Although Schlosser later seized on these unredacted references to support its arbitration demands, Schlosser did not dispute that it was well known in the construction industry that the School Board could not arbitrate. As the District Court concluded, "the intent of the parties was to take out the arbitration provisions in the contract even though it may have been mentioned in passing in another area or two of the contract." (Petition at 26a).[16] Since this case would not have arisen but for this unintended drafting omission, its precedential value is quite limited, and it provides an ill-equipped vehicle with which to revisit the law surrounding the FAA.

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[16] The Contract at issue here also provided that Virginia law would apply, (Petition at 71a, ¶ 7.1.1); and that, if any conflict arose between the provisions of the Contract and the Virginia Public Procurement Act, the Virginia Public Procurement Act would control (Petition at 102a-103a, ¶ 7.11.1). The first choice-of-law provision was identical to that applied by this Court in *Volt Info. Sciences, Inc. v. Stanford Univ.*, 489 U.S. 468, 470 (1989) (holding that the FAA did not preempt a California statute permitting a court to stay arbitration proceedings pending litigation of related claims, where the parties had agreed that

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CONCLUSION

The Court of Appeals' decision properly applied the principles enunciated by this Court in footnote 9 of *Perry v. Thomas*, and did not create any split in the Circuits. Accordingly, review by this Court is not warranted, and the Petition for Writ of Certiorari should be denied.

Respectfully submitted,

FAIRFAX COUNTY SCHOOL BOARD

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California law would apply). The second provision also reflected that the parties never intended to arbitrate their disputes, because the Virginia Public Procurement Act, Va. Code Ann. §§ 11-35 to -80 (Michie 1989 & Supp. 1992), which sets forth procedures for resolving contract disputes between public entities and private contractors, does not provide for arbitration. *See W.M. Schlosser Co.*, 980 F.2d at 256 ("Indeed, the Act would appear to prohibit, by negative inference, decision by an arbitrator. . . .").